

## **Update on Voluntary Self-Disclosures at the Bureau of Industry and Security**

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The November 3, 2006, administrative settlement reached between the Bureau of Industry and Security (BIS) and EPMedSystems for violations of the Export Administration Regulations (EAR) has generated much interest in the export trade community. This settlement reinforces the importance of voluntarily self-disclosing export control violations and ensuring that such disclosures are full and accurate. This case also highlights the danger of making willful misstatements to BIS.

The proposed charging letter issued to EPMedSystems contained 23 violations, including multiple charges of false statements, conspiracy, exporting and reexporting with knowledge, and evasion in connection with unlicensed shipments of medical equipment to Iran. Those familiar with BIS charging decisions know that evasion, conspiracy, and knowledge charges are not issued against companies that simply make a procedural mistake but rather are based on evidence of knowing, and willful violations. In fact, this is the first time that BIS has charged a company with making false statements in connection with a Voluntary Self Disclosure (VSD). This was a significant decision that was not made lightly. The ultimate settlement, jointly agreed to by both BIS and EPMedSystems, of a penalty equal to 96% of the maximum possible fine, was entered into in recognition of the seriousness of the violations involved.

Much of the recent discussion, including some Internet postings, is not fully informed and misses the larger point that experienced export control practitioners understand: companies that file accurate and thorough VSDs in accordance with the EAR receive great weight mitigation. By contrast, those that are not accurate and thorough, and certainly those intended to deceive BIS do not receive great mitigation. It is hard to believe that honest exporters would, as some seem to suggest, think that a company that files a materially incomplete, misleading, and/or false VSD with BIS should receive the same mitigation as a company acting in good faith that files a complete and accurate VSD. Most harmful are the conclusions of some that companies should never file a VSD with BIS unless they are “almost certain” that BIS will otherwise discover the export and that a company should not file a preliminary voluntary disclosure at all due to the risk of being charged with misrepresentations. Neither a statistical analysis of VSD cases for the last three years nor the EPMedSystems case itself supports those conclusions.

A look at the larger VSD picture and how BIS treats VSDs demonstrates the fallacy of these erroneous conclusions. First, not all VSDs are created equal and not all should be, or are, handled the same. In deciding how to handle a particular case involving a VSD, BIS looks at the totality of the circumstances, at facts that may not be a part of the public record and at all relevant variables.<sup>1</sup> Second, that being said, there are patterns of resolutions that should encourage companies who are considering filing a VSD. The tables in this article demonstrate that

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<sup>1</sup>See the guidance published at the BIS website:  
[www.bis.doc.gov/ComplianceAndEnforcement/VSDPaper101105.pdf](http://www.bis.doc.gov/ComplianceAndEnforcement/VSDPaper101105.pdf)

EPMedSystems is one of the limited number of VSD cases that have resulted in a fine of more than 50% of the maximum.<sup>2</sup> Third, EPMedSystems did benefit from filing a VSD – many companies with violations this serious end up in the criminal system and/or with denial orders. By not waiting until it was “almost certain” that the violations would be discovered (a somewhat naive approach given the new Patriot Act tools and heightened consciousness of the national security risks posed by illegal exports), EPMedSystems continues to operate.

To understand EPMedSystems in the larger picture of VSDs, it is important to understand the process BIS uses in handling VSDs generally. When a VSD is filed, BIS first seeks to determine whether there has, in fact, been a violation of the Export Administration Regulations (EAR). If there is no violation, the matter is concluded and BIS will advise the submitting party of that determination.

If a violation has occurred, BIS then determines the appropriate way to respond to that violation to achieve the enforcement objectives of improving compliance, preventing violations, and bringing violators to justice. BIS has several options, based on the nature of the violation, to address export violations, the facts of the case, and the applicable legal requirements. BIS may:

- Issue a Warning Letter, not as a penalty action, but to inform and educate the involved parties regarding their conduct and provide a basis for future compliance;<sup>3</sup>
- Assess administrative enforcement penalties, including monetary penalties as well as denials of export privileges, as provided in the EAR, Parts 764 and 766; and
- Pursue criminal prosecution of parties involved in willful violations, in coordination with the Department of Justice and United States Attorneys.

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<sup>2</sup>Tables setting forth the administrative resolution of all VSD cases for the period 2004 to 2006 will be posted shortly on the BIS website.

<sup>3</sup> A Warning Letter is not made public nor is the fact of its issuance. Prior warning letters are an aggravating factor in determining the resolution of a subsequent violation, a factor which can result in higher penalties.

The following chart illustrates the trend over the last three years (Table 1):

| Year | VSDs<br>filed | VSDs<br>Resolved | No<br>violation | Warning Letter | Administrative<br>Sanction | Criminal<br>Sanction |
|------|---------------|------------------|-----------------|----------------|----------------------------|----------------------|
| 2004 | 78            | 63               | 18 (29%)        | 37 (59%)       | 8 (12%)                    | 0                    |
| 2005 | 148           | 98               | 44 (45%)        | 52 (53%)       | 2 (2%)                     | 0                    |
| 2006 | 141           | 47               | 23 (49%)        | 24 (51%)       | 0                          | 0                    |

As Table 1 demonstrates, more than 95% of the VSDs received and resolved in the past three years, were resolved without the issuance of administrative enforcement penalties. Moreover, the useful information received by BIS regarding foreign parties involved in illicit efforts to acquire sensitive U.S. items through these disclosures can significantly advance BIS's understanding of, and response to, ongoing national security challenges in the export enforcement context. Accordingly, BIS encourages self-disclosures even when the violation is not certain.<sup>4</sup>

In the low percentage of VSD cases where administrative penalties and criminal sanctions are appropriate, BIS will pursue that course. Clearly, the nature and scope of the disclosed violations, as well as their impact on U.S. national and economic security are considered by BIS in deciding what action to take in response to a VSD. Increasingly, however, BIS is reserving administrative and criminal prosecutions to the most egregious, repetitive, and willful violations involving such issues as WMD proliferation, terrorism and State support of terror, and diversions to unauthorized military end uses.

Where BIS does elect to pursue administrative enforcement penalties to resolve a VSD, a full and accurate VSD that complies with the EAR is afforded "great weight." In VSD cases, BIS begins its penalty calculations by making a 50% reduction of the maximum penalty, with adjustments subsequently made for any aggravating and/or mitigating factors. This is meant to serve as an incentive to parties. In non-VSD cases, mitigation rarely reaches below a 50% reduction of the maximum penalty, to ensure that VSDs consistently receive a preferential treatment in BIS's penalty program.

Table 2 covers the total number of cases resolved administratively in 2004 to 2006, most of which were filed earlier than the year in which they were resolved. It demonstrates just how rarely a resolution such as EPMedSystems occurs. For example, of the 63 cases resolved with penalties in 2004, only 12 stemmed from VSDs and of these settlements, only one resulted in a

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<sup>4</sup> As indicated by the rising numbers of VSD filings, exporters in recent years understand and are taking advantage of the benefit of filing VSDs.

penalty greater than 50% of the maximum fine.

| Year | Total Cases Resolved Administratively | VSDs Resolved by Administrative Penalty | Cases Resolved with Fines More than 50% of Maximum Fine |
|------|---------------------------------------|---|---|
| 2004 | 63                                    | 12                                      | 1   |
| 2005 | 69                                    | 18                                      | 2   |
| 2006 | 95                                    | 28                                      | 3   |

In fact, in the majority of these 58 VSD cases that were resolved with the imposition of an administrative penalty, fines imposed were below 35% of the maximum. For those VSD cases that resulted in fines above 50% of the maximum, in most instances, the VSD only covered some of the counts. Despite the incomplete VSD, the companies were given full great weight mitigation as to the violations which were disclosed. In other instances, there were significant aggravating factors such as prior Warning Letters, national security violations, delays in settling which resulted in expenditure of significant resources, or knowledge approaching willfulness.

In one illustrative case, Dresser Italia, which was charged with 120 violations involving exports and reexports to Libya and Iran, including acting with knowledge charges, BIS stated, “Dresser Italia management were focused on making sales to the point that they disregarded U.S. export controls, and certain Dresser Italia personnel stated that they did not agree with the strictness of the U.S. export regulations.” BIS does not take evidence of willful violations of the export control laws lightly and, as a result, it is BIS’s practice to impose more severe penalties on more culpable conduct, especially if it involves exports to a country that is a State sponsor of terrorism. However, BIS and Dresser agreed to settle the Dresser Italia matter for 62% of the maximum possible fine. The other seven Dresser cases that were included in the VSD, all settled for 30% or less of the maximum possible fines.

In another VSD case that settled for 77% of the maximum fine, Ingersoll-Rand was charged with unlicensed exports of pumps to various countries, including China, India, and Taiwan. Ingersoll-Rand had voluntarily disclosed some of the exports, and some were discovered by BIS during its investigation. When settlement negotiations failed, BIS filed a charging letter with an Administrative Law Judge alleging 80 violations, including 28 acting with knowledge charges. A case that must be filed before an Administrative Law Judge requires BIS to expend significant resources and, as stated in the Penalty Guidelines, that case will not receive the same degree of mitigation as a case that settles prior to the initiation of formal proceedings. That delay and the undisclosed violations contributed to the penalty amount higher than 50% of the maximum.

As to the timing of a VSD submission, whether to file a preliminary disclosure when all the facts regarding a violation are not yet known, BIS strongly urges submission of a VSD at the earliest opportunity and provides for that in the Regulations. To do otherwise is to risk discovery or exposure by a third-party, including the Government, thereby eliminating the opportunity for “great weight” mitigation. Early disclosure allows BIS to work with the disclosing party to perfect the disclosure and move towards compliance. Disclosing parties should, however, take pains to clearly state what they do and do not know, and to ensure that all submissions made to BIS are as accurate and complete as possible, to avoid any questions that may later arise about the veracity of the disclosed information. Other than EPMedSystems, none of the other numerous cases with initial disclosures followed by more complete VSDs resulted in additional charges. EPMedSystems is a unique case that should not be the basis for questioning good compliance practices, including VSDs, but should reinforce the wisdom of following the guidance provided in Part 764.5 of the EAR on VSDs.

Of course, disclosure of violations to BIS and BIS’s action on VSDs are not the only steps needed to fully address noncompliance issues. Disclosing parties must also continue internal improvement of their compliance efforts, programs, and processes. Corrective actions to address the underlying causes of noncompliance and to ensure that violations do not recur are a critical part of companies’ overall export compliance programs. In order to avoid a denial order in cases involving knowledge, BIS looks particularly closely at the possibility of recurrence. Factors considered include the continued employment of culpable employees, the actual implementation of the export compliance program set forth on paper, and senior management commitment to future compliance.

In summary, statistics show that the vast majority of VSDs are resolved by means other than the issuance of administrative enforcement penalties. Resolution of VSDs is done on a case by case basis, after a complete review of the totality of the circumstances. VSDs are important tools, not just for achieving our objective of compliance with export requirements, but also for providing potentially important information to BIS regarding the illicit activities of other parties.

It is in the national interest to ensure that companies have an incentive to continue voluntarily self disclosing potential violations. BIS encourages any party who believes they may have violated the EAR to submit a VSD. Further information on submitting VSDs is available on the BIS website and in Part 764.5 of the EAR. Industry compliance with export requirements is an important contribution to national security and VSDs are an important tool for use by exporters in making that contribution.